Ennismore European Smaller Companies Fund

Investor Newsletter for the month of October 2017

Issued on 7 November 2017

Fund Details

Daily dealing UCITS and Irish Central Bank regulated open-ended investment company with Financial Conduct Authority recognition and registered in Ireland. The Fund size was GBP 385m as at 31st October. Total assets under management by Ennismore Fund Management were GBP 634m. Our funds are hard closed to new investment with the number of shares in issue capped and we have a waiting list of clients that want to invest as and when capacity becomes available through redemptions. If you would like to be included on this please call Eleanor Scott on +44 (0) 20 7368 4219 or email subs@ennismorefunds.com. Redemptions can be made through the Administrator in the usual way.

The Fund is managed as an absolute return fund with the objective of generating positive returns irrespective of market conditions rather than performing relative to any benchmark index. Index data is provided in the following table as a guide to general equity market conditions.

Performance as at 31 October 2017

	Share Class[2]					HSBC Index[3]		MSCI Index[4]
	GBP A £	**GBP A €**	**GBP B**	**EUR A**	**EUR B**	**GBP**	**EUR**	**(local)**
NAV per Share[1]	**124.05**	**141.41**	**20.96**	**20.33**	**20.40**			
Period	**% Change**					**% Change**		
October 17	**-1.2**	**-0.8**	**-1.2**	**-0.9**	**-0.8**	**1.0**	**1.6**	**2.1**
September 17	-1.2	3.4	-1.3	2.6	2.5	-0.2	4.3	2.7
August 17	1.5	-1.6	1.5	-1.0	-1.0	2.1	-0.8	0.1
July 17	2.7	0.9	2.7	1.2	1.2	2.8	0.7	0.6
June 17	-0.6	-1.4	-0.5	-1.2	-1.2	-1.8	-2.4	-2.3
May 17	2.2	-1.2	2.2	-0.6	-0.6	5.5	1.9	2.6
April 17	1.0	2.7	1.0	2.4	2.4	3.1	4.5	1.5
March 17	0.9	0.7	0.9	0.8	0.7	2.3	2.5	3.5
February 17	-0.2	0.4	-0.2	0.3	0.3	2.5	3.0	2.8
January 17	1.2	0.6	1.2	0.7	0.7	1.8	1.4	-0.3
2017 to date	**6.5**	**3.6**	**6.4**	**4.1**	**4.1**	**20.8**	**17.7**	**14.0**
Annualised return[5]	**14.5**	**13.1**	**11.5**	**11.1**	**11.1**	**10.4**	**9.0**	**4.5**
Since launch[5]	**1163.9**	**904.1**	**109.6**	**103.3**	**104.0**	**541.2**	**407.9**	**126.6**
	Discrete 12 Month Rolling Performance - % Change							
To 31 October 17	5.6	8.3	5.6	8.1	8.1	22.7	25.5	19.8
To 31 October 16	20.6	-4.1	20.7	-0.1	-0.1	22.5	-2.6	0.0
To 31 October 15	6.9	17.0	6.9	15.0	15.0	13.3	24.4	8.7
To 31 October 14	8.2	16.9	8.2	15.4	15.3	-2.6	5.3	4.6
To 31 October 13	26.3	20.1	26.3	21.4	21.3	41.2	34.0	24.5

[1]Source: Administrator, Net Asset Value. [2]Source: Administrator, Net Asset Value, net income reinvested. [3]Source: Bloomberg, Euromoney (formerly HSBC) Smaller European Total Return Index. [4]Source: Bloomberg, MSCI Europe Index, local currencies, total return. [5]Since inception of GBP A share class on 27/01/99 to date, GBP B share class on 19/01/11 to date, EUR A and EUR B share classes on 31/01/11 to date. Note: All performance figures net of fees. **Past performance is not a guide to future returns.**

Comments below on performance refer to GBP NAV per share unless otherwise stated, exclude cash returns and are prior to expenses.

The Fund's NAV fell by 1.2% in October. Our long and short books cost 0.3% and 0.8% respectively. The only notable attributions for the portfolio were on the short book with a German software company and a UK semiconductor supplier both detracting 0.5%.

Costain – UK engineering and construction company (3.1% NAV)

Costain is a construction company with a market capitalisation of GBP 460m that focusses on projects in segments of the UK market with attractive long term structural and regulatory drivers. Whilst a poor approach to risk management on fixed price contracts combined with low profit margins has meant that construction companies are often unattractive investments, we believe Costain is different and this is overlooked by the market. The segments in which they operate require specialist engineering expertise, innovative solutions, and sometimes the need to incorporate technology into the project to win contracts. Working closely with their customers in a consultancy like partnership reduces the competitor set Costain faces, and typically there are just two to three bidders for a project. Unlike a traditional construction firm, contracts are based on cost reimbursement with profit gains for hitting targets rather than fixed price contracts. Costain also has strong visibility with an order book of around GBP 3.7bn versus sales of GBP 1.6bn in 2016. All this leads to a more defensive, higher margin, better quality earnings stream than an average construction company.

The infrastructure sector which covers the highway, rail and nuclear energy markets accounts for GBP 1.2bn of its revenue. Infrastructure has been the key profit generator in the last three years as revenues have increased by two thirds and the division has delivered operating margins before central costs towards the top of the 4-5% target range. Rail and highways are at the core of this division and both are benefiting from the increasing investments needed to increase capacity and alleviate overcrowding. Examples of projects include the conversion of highways to 'smart' motorways enabling the use of hard shoulders as a traffic lane or helping to build the infrastructure required for the High Speed Two rail line connecting London to Birmingham. The remaining GBP 0.4bn is in Natural Resources, made up of the water, power and oil & gas industries. This division has had a tough time in the same period due to weakness in the oil & gas sector as well as problems with a legacy fixed price contract awarded in 2007 in waste energy, which is now completed but which we estimate has cost the company at least GBP 40m. Typical work here would be projects to structurally reduce water leakages in the wastewater network or developing gas storage solutions. Now the legacy issues are behind them and the oil & gas market seems to have troughed we would expect margins in this segment to increase, although we don't expect the 4-5% margin target to be achieved in the near term.

The strong management team have both been in the business for over 10 years and in that time have moved the company into being the differentiated offering it is now. This transformation has been assisted by bolt-on acquisitions to give the technology and expertise to add value for customers as well as hiring PhD graduates in niche technology areas to build their in-house technical capabilities. As an aside, longer term we wouldn't be surprised if the company becomes an acquisition target given its niche positioning in the higher quality part of the construction market (covering over GBP 20bn of a total GBP 100bn UK construction market), although as always this is not the reason for owning the stock.

In the first half of the year, profits grew around 35%, as sales grew over 11% and legacy costs dropped out. We expect growth of over 20% for the year to GBP 50m post central costs of GBP 7m and prudently expect this to increase by over 10% next year. The balance sheet is strong with net cash, including the pension deficit, of GBP 44m as of first half 2017, although cash flow will be weak this year due to the reversal of a working capital benefit in 2016. Return on invested capital after tax is close to 50% due to it being an asset light business and having a tightly managed working capital cycle leading to negative working capital. This financial strength and low capital requirement enables an attractive and growing 3% dividend yield.

We believe Costain is currently being overlooked by the market, despite having a strong focus on growth areas with higher quality contracts and strong customer relationships. We value the stock very conservatively at 12 times enterprise value to post tax operating profits, which leads to upside of over 35% by the end of 2018.

Top Five Long Holdings as at 31 October 2017

	Company	Country	Sector	% of NAV
1	Jd Sports	United Kingdom	Consumer Discretionary	5.8
2	Cegedim	France	Health Care	3.2
3	Kongsberg Auto	Norway	Consumer Discretionary	3.2
4	Costain	United Kingdom	Industrials	3.1
5	Vib Vermoegen	Germany	Real Estate	2.8
				18.1

Exposures as at 31 October 2017

Longs %	Shorts %	Gross Exposure %	Net Exposure %
75.1 (74.6)	52.9 (51.4)	128.0 (126.0)	22.2 (23.2)

Figures in brackets refer to previous month end.

Exposures by Country, Market Cap & Sector as % NAV and Positions as at 31 October 2017

Country	Gross%	Net%
Australia	1.4	0.7
Austria	2.8	0.5
Belgium	1.1	-0.4
France	7.1	7.0
Germany	32.0	5.0
Hong Kong	2.0	-2.0
Italy	4.6	4.0
Netherlands	5.0	-3.8
Norway	7.0	6.6
Spain	1.5	-1.5
Sweden	2.2	0.2
Switzerland	5.5	-5.0
UK	45.5	13.0
US	8.7	-2.4
Other	1.6	0.3

Market Cap	Gross%	Net%
>£2bn	38.9	-5.6
£700m - £2bn	32.6	-2.7
£200m - £700m	36.9	13.2
<£200m	19.6	17.3

Positions	Oct	Sep
Long	89	85
Short	79	81
Longs Opened	4	3
Longs Closed	0	4
Shorts Opened	9	1
Shorts Closed	11	5

Sector	Gross%	Net%
Consumer Discretionary	39.5	14.2
Consumer Staples	9.4	-4.4
Energy	0.0	0.0
Financials	7.1	1.9
Health Care	5.8	3.8
Industrials	20.1	5.5
Information Technology	27.7	-4.0
Materials	4.2	3.4
Real Estate	8.2	2.6
Telecommunication	5.5	-0.3
Utilities	0.5	-0.5
Other	0.0	0.0

Geographic analysis relates to country of incorporation or listing. This may not represent the underlying economic exposure of the operating business.

For further information please contact:	Eleanor Scott, Ennismore Fund Management	+44 (0) 20 7368 4219	subs@ennismorefunds.com
For dealing please contact:	Northern Trust International Fund Administration Services (Ireland) Ltd	+353 (0) 1 434 5103	Ennismore_TA_Queries@ntrs.com

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For further information please contact:	Eleanor Scott, Ennismore Fund Management	+44 (0) 20 7368 4219	subs@ennismorefunds.com
For dealing please contact:	Northern Trust International Fund Administration Services (Ireland) Ltd	+353 (0) 1 434 5103	Ennismore_TA_Queries@ntrs.com